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25 October, 1983

MEMORANDUM FOR: Mr. Paul Balabanis
 Director, Planning and Economic Analysis Staff
 Department of State

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FROM: [redacted]
 Office of European Analysis
 [redacted]
 Analytic Support Group

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SUBJECT : Impact of Higher Oil Prices on OECD Growth
 and Inflation

1. Per your telephoned request on 24 October 1983 we are enclosing some simulation results showing the estimated impact on the OECD of a large increase in the price of oil. These simulation results, derived from our Linked Policy Impact Model (LPIM) should be considered tentative, first because the oil price increase simulated is so large (about \$70 dollars) as to be beyond the bounds of experience used to estimate the model, and second, given the magnitude of the increase our assumption of no change in government policies is not very realistic.

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2. In these simulations, the price of oil is assumed to rise from \$29.00 in 1983 (and 1984) to \$98.00 in 1984--due to a hypothetical net supply shortfall of roughly nine million barrels a day--and remain at that price in nominal terms through 1986. This price increase causes the aggregate OECD real GNP growth rate in 1984 to drop from a baseline rate of 3.4 per cent in 1984 to -0.9 per cent. The average rate of inflation in the OECD rises almost 10 percentage points, and the aggregate OECD current account balance worsens by over \$110 billion.

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3. In the attached tables the results from simulation "BASE1003" are the baseline projections which are a combination of model forecasts and analyst judgments. In the simulations "HIGH OIL" the world price of traded oil is increased while all other exogenous and policy variables are held unchanged.

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4. We are now working on a refinement of this analysis which we would be happy to make available to you when it is completed. If we can be of assistance in providing other simulation analysis, please feel free to call us [redacted]

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